AMBIGUITY, MONETARY POLICY AND TREND INFLATION

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Abstract
Allowing for ambiguity about the behavior of the policymaker in a simple New-Keynesian model gives rise to wedges between long-run inflation expectations, trend inflation, and the inflation target. The degree of ambiguity we measure in *Blue Chip* survey data helps explain the dynamics of long-run inflation expectations and the inflation trend measured in the US data. Ambiguity also has implications for monetary policy. We show that it is optimal for policymakers to lean against the households' pessimistic expectations, but also document the limits to the extent the adverse effects of ambiguity can be undone. (JEL: D84, E31, E43, E52, E58)

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